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Honorable Reed Hundt
Chairman
Federal Communications Commission
1919 M Street N.W., Room 814
Washington, D.C. 20554

Re: MM Docket No. 92-266
Seventh Notice of Proposed Rulemaking

Dear Chairman Hundt:

As part of its "Going Forward Order," the Commission has solicited comment on a proposal to eliminate the 7.5 percent mark-up on programming cost increases for channels offered before May 15, 1994. On behalf of ESPN and ESPN2, I am writing to urge the Commission to reject this proposal and to retain a mark-up on programming cost increases for existing channels.

In reissuing its "going forward" rules, one of the Commission's stated purposes was to encourage cable operators to offer new and higher quality program services on their regulated tiers of service. The Commission candidly admitted that its original efforts to inspire the availability of more diverse and higher quality service had not succeeded. Cable operators in the main found no economic basis to add channels where the only return was 7.5 percent above programming costs plus a de minimis 1-2 cent surcharge for the utilization of channel capacity. In the Going Forward Order, the Commission took steps to improve the incentives for adding new services. Yet it is ironic, indeed, that in the same document the agency has proposed to eliminate the 7.5 percent markup on program cost increases, thereby removing the minimal incentive previously provided for ESPN and cable operators to improve program quality.

The principal reason given for proposing to eliminate the 7.5 percent mark-up on programming cost increases for existing channels is that the mark-up no longer may be necessary given "the total incentive structure" provided by the revised going forward rules. In fact, however, the new going forward structure is designed to reflect the amount a cable operator would charge subscribers for adding a channel in a competitive environment, not the recovery of increased investment in existing channels. Moreover, as the Commission knows, many cable operators have little or no capacity available to add new channels. For these systems, the "total incentive structure" in the revised going forward rules offers no means of offsetting the reduction in margins that will occur as existing services increase their programming costs[1].

Reducing margins appears to be of little concern to the Commission in its proposal to eliminate the 7.5 percent mark-up. But this is not financial gibberish or balance sheet sleight of hand. This mark-up is especially critical to cable programmers, such as ESPN, who acquire and produce high cost programming and, thus, have higher than average subscriber fees. The margin that these higher cost cable networks offer operators above the permitted per channel benchmark rate is relatively small and must cover all other capital and operating costs. Eliminating the 7.5 percent mark-up for increases in programming costs of higher cost networks will cut further into this already slim margin. If the Commission's "going forward" rules are genuinely aimed at assuring a reasonable number of high quality new and existing services on regulated tiers, eliminating the 7.5 percent mark-up will most immediately undercut and prejudice those services which are and have been providing consumers with ever increasing diversity and quality on cable.

While ESPN and ESPN2 are hopeful of some greater carriage as a result of the Commission's revised incentives for cable operators to add new services, we are greatly troubled by the notion that the price for these incentives is a reduction in the operator's return on its investment in existing cable channels. ESPN's growth and development from its humble origins to its current position as the most widely distributed sports programming service in the United States, featuring major professional and college sporting events as well as award-winning sports news and commentary, is well known. That growth and development was fueled by a massive investment in programming -- an investment that was shared by ESPN's cable operator affiliates. As ESPN, and now ESPN2, continues this development, additional investment will be required. In order for cable operators to support this investment, it is imperative that they be permitted a fair return. Accordingly, the Commission's rules should continue to provide for a mark-up on programming cost increases for existing services.

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[1] It is noteworthy that the Commission's revised "going forward" rules inherently favored the lower cost and free new service offerings by allowing an additional 20 cent mark-up regardless of cost. The "cap within a cap" evidenced some desire to temper the advantage given to the no cost service. Eliminating the mark-ups for existing more costly services ignores the need for a balance between high and no or low cost offerings.

If you have any questions regarding this matter, please do not hesitate to contact the undersigned.

Sincerely,

Edwin M. Durso

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EMD/grh

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